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**POLICY NUMBER:** 2.10.700**EFFECTIVE DATE:** 2/19/04**TITLE:** Private Equity Investing**SUPERSEDES:** 3/21/02**BOARD ADOPTION:** 3/21/02**APPROVED:** *Joseph A. Dea*

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**PURPOSE:**

This section sets out the general policies and guidelines for private equity investing. The purpose of the private equity investment program is to prudently employ the assets that the Washington State Investment Board (WSIB) has allocated to private equity investments to produce a well-diversified profitable portfolio that will enhance the total return of the WSIB portfolio and ultimately pay benefits to participants and beneficiaries and meet actuarial requirements.

**POLICY:****Objectives and Goals**

The objectives and goals of the private equity investment program are to:

1. Achieve superior total returns compared to traditional asset classes and exceed the return of the S&P 500 (total time-weighted return including dividends) by 500 basis points in the long run.
2. Diversify away from traditional capital market risks.
3. Employ consistent strategies that contain sufficient flexibility to take advantage of changes in the private equity or debt marketplaces available to the WSIB.
4. Endeavor to provide ancillary benefits to the WSIB including, but not limited to:
  - negotiation of special terms based on the WSIB's size, its attractiveness to any one general partner, and its ability to attract other investors;
  - establishment of strong general partner relationships that may enhance later direct investment deal flow; and
  - promotion of staff-consultant interaction to leverage the consultant's private equity investment experience.

5. Invest as a limited partner in a variety of carefully chosen limited partnerships, each with a successful track record, consistent investment strategy, and stable management.
6. Develop secondary market capabilities to enhance the WSIB's ability to minimize losses and maximize returns by enabling it to sell its interest in a private equity asset prior to maturity or liquidation, if prudent to do so, or, alternatively, to invest in established partnerships in the secondary market.
7. Emphasize professional and timely handling of private equity investment proposals in order to present the WSIB as a sophisticated, cutting-edge investor in the private equity investment field.
8. Implement a standardized and thorough method of proactively monitoring portfolio investments to maximize profit realization.
9. Develop in-house expertise and resources for the prudent employment of funds in private equity investments, and refine the use of consultants/outside experts to augment the staff's capabilities.
10. Assess the private equity investment program's performance, strategies, and objectives on a continuing basis to permit flexible responses to changing circumstances.
11. Maintain the stability of the private equity investment program by following established guidelines and procedures; only alter policies and strategies after careful consideration.
12. Comply with all applicable laws and regulations concerning the investment of the WSIB's pension assets.

### **Scope of Investing**

The WSIB can invest in any appropriate private equity investment opportunity that has the potential for returns superior to traditional investment opportunities and is not prohibited by the WSIB's policies or by law. These investment types are generally divided into venture capital, corporate restructuring, international, distressed, mezzanine, and other investments. Private equity investments are made either through limited partnership or direct investment vehicles and in a manner consistent with RCW 43.33A.110, which mandates that "the Board shall establish investment policies and procedures designed exclusively to maximize return at a prudent level of risk."

### **Allocation and Diversification**

The following provides a prudent and disciplined approach to achieving a well-diversified portfolio of private equity investments that should realize superior investment returns as an asset class.

#### **A. Overview**

To meet return and plan objectives, it is prudent to diversify the private equity portfolio over time among the universe of private equity investments. Specific guidelines for each category will vary over time, depending on conditions in the macro environment and specific opportunities available.

#### **B. Diversification Categories**

In selecting specific investments, it is important to seek an appropriate balance among the following categories of diversification:

1. **Stage** - A diversified portfolio of companies in a variety of stages of growth should be sought. These stages, for example, can include, but are not limited to:

Early Stage:	Seed Financing Start-Up Financing First Stage Financing
Expansion:	Second Stage Financing Third Stage or Mezzanine Financing
Later Stage:	Bridge Financing Corporate Restructuring
2. **Concentration** - Attention must be paid to the amount that the WSIB, or any limited partnership in which it invests, should place in any one investment opportunity. Typical limited partnership agreements have limitations on the percentage of the partnership's committed capital to be invested in any one company. The WSIB should not consider taking more than 40 percent of any single partnership except in unusual circumstances.
3. **Industry Sector** - The portfolio should be diversified across a broad cross-section of opportunities in different industries.
4. **Geographic** - The private equity portfolio should be broadly diversified by geographic region and may seek to include investments in Europe and the Pacific Rim, as well as other areas of the world as appropriate opportunities are identified.

5. Time/Term of Commitment - To avoid excess exposure to any one economic or investment cycle, it is important to structure a private equity portfolio so that a significant number of its investments are not made at the same time and do not mature at the same time. Accordingly, the private equity investment portfolio should be designed to seek a spectrum of investment and maturity dates.

Diversification also requires recognition of the need to balance niche opportunities in a specific market area with generalist approaches in selecting private equity investment opportunities. A well-balanced portfolio should contain both niche and generalist type investments.

### **Implementation**

The investment strategy and guidelines embodied in this plan are carried out by the Private Markets Committee, staff, and the consultant, as outlined in the procedures contained in Exhibit 1, with due regard for the private equity investment policies adopted. The procedures are intended to be a stable implementation mechanism to apply the substance of this plan. The WSIB is, by virtue of this plan and its guidelines, well-positioned and flexible enough to act on private equity investment opportunities as they arise.

One of the most critical phases of the private equity investment process is the due diligence performed by the consultant and staff. To facilitate this phase, the staff and consultant have each developed standard due diligence procedures to evaluate proposed investments across a wide range of factors.

Due diligence includes, but is not limited to, the following:

1. analyzing the investment track record of the principals;
2. evaluating the proposed investment strategy and the fit of the proposed investment within the WSIB private equity portfolio;
3. reviewing the use of financial leverage;
4. assessing the ability and stability of the investment management team and the investment organization;
5. reviewing market conditions;
6. identifying potential competitors and evaluating sources of deal flow;
7. conducting reference checks;

8. conducting face-to-face meetings with the principals to discuss important aspects of the offering;
9. reviewing the offering memorandum and related documents, including the most recent partnership financial statements and the most recent audited financial statements;
10. reviewing the proposed business plan and exit strategies;
11. identifying and resolving key issues; and
12. reviewing the proposed terms, conditions, and fees of the partnership.

All private equity investments must be approved by the Board following the recommendation of the Private Markets Committee, as outlined in Exhibit 1, with the following exceptions:

1. The Board has contracted with discretionary venture capital managers that have been given allocations to be invested at their discretion, subject to contractual investment guidelines established by the Board. The Board may periodically authorize allocations to these managers for discretionary investments.
2. The executive director, subject to the restrictions outlined below, shall have authority to invest up to \$100 million annually in secondary market opportunities in private equity limited partnerships. No single investment shall be greater than \$35 million.

Authority shall only be exercised with a unanimous recommendation by the chief investment officer and the senior investment officer for private equity, acting upon a favorable due diligence determination by the WSIB's private equity investment consultant. Proposed investments in the secondary market may only be considered when staff and the consultant believe that the investment is being obtained at a discount to the current market value for such investment.

The favorable due diligence determination, including the underlying rationale, market conditions, and portfolio impact, shall be furnished to the Private Markets Committee and the Board at their next regularly scheduled meetings.

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Formerly Policy Number 2.05.300 dated 12/15/92

Supersedes Policy 2.10.400 dated 6/13/88

Board Adopted Policy 2.10.700 dated 12/15/92

Revised 2/20/97

Revised 4/16/98

Revised 3/21/02

Revised 2/19/04

**Private Equity Investing**  
**Overall Process - 2/19/04**  
**Exhibit 1**

**Schematic of the Overall Investment Process**

	Consultant	Staff	Staff/Committee	Board
Possible opportunity identified by staff, consultant	1 Consultant engages in thorough due diligence of investment	1 Staff engages in thorough due diligence of investment	3 Staff provides status report of all due diligence activity to Private Markets Committee	
	2 Consultant provides written recommendation to Private Markets Committee	2 Staff provides written recommendation to Private Markets Committee	4 Staff/consultant make presentation to Private Markets Committee	
			5 Fund principals make presentation to Private Markets Committee	
			6 Private Markets Committee makes recommendation to full Board	
				7 Board approves/disapproves investment and commitment amount subject to partnership agreement negotiation
	8 Partnership agreement reviewed by Senior Assistant Attorney General, outside legal counsel, WSIB staff and consultant			
	9 Negotiation of partnership agreement - all legal counsel, staff, Senior Assistant Attorney General, fund managers, and consultant			
		10 Executive director executes partnership agreement		
		11 Staff monitors partnership/consultant prepares quarterly report		

\* Staff and consultants' investment recommendation and the Board's approval/disapproval of that investment transpire in the same month.